DL-108557-97
Br2:DLambert-Dean

Assistant Commissioner (International)
Attn: Director, Office of Financial Products and Transactions CP:IN

Chief, Branch 2 (Disclosure Litigation) CC:EL:D

FOIA Requests on Mark-to-Market Valuation Software

This is in response to your memorandum of April 10, 1997, in which you requested our advice as to what records associated with the "Mark-to-Market Valuation Software" currently being developed for the IRS under contract with the Los Alamos National Laboratory would be available to the public under the Freedom of Information Act [FOIA].

ISSUE

(1) What data from the unfinished version of the "Mark-to Market Valuation Software" is available to a requester under the FOIA?

(2) Does the IRS/Los Alamos National Laboratory need to save and make available data which is discarded as the product is developed?

CONCLUSION

(1) Data associated with the unfinished "Mark-to-Market Valuation Software" is subject to the deliberative process privilege and would be exempt from disclosure pursuant to exemption 5 of the FOIA. However, the assertion of the deliberative process privilege is discretionary and IRS internal policy directs that this privilege not be asserted unless it has been determined that disclosure of the requested records would cause foreseeable harm to the interests of the agency. Furthermore, pursuant to a memorandum issued by Attorney General Janet Reno, it is the policy of the Department of Justice to defend the assertion of a FOIA exemption only in those cases where the agency reasonably foresees that disclosure would be harmful to an interest protected by that exemption. Consequently, the effect on the interests of the agency of the release of relevant information is a factor that must be considered in the event a FOIA request is made for this data.

(2) If information is subject to destruction under applicable record retention schedules, there is no need to retain it because of anticipated FOIA requests. The FOIA does not require either the retention or retrieval of discarded data

which was not incorporated into the final version of the "Mark-to-Market Valuation Software."

ANALYSIS

Background

Section 475 of the Internal Revenue Code requires that dealers in securities use a mark-to-market method of accounting. Under that method, inventory securities must be included in inventory at fair market value. The IRS intends to implement mark-to-market valuation software to assist with the administration of section 475. The "Mark-to-Market Valuation Software" is currently under development by the Los Alamos National Laboratory with an expected completion date of October 1997. At a meeting on April 3, 1997, the software was publicly discussed and demonstrated with representatives of major financial institutions. On May 29, 1997, the IRS described the software under development and solicited comments regarding methodologies being incorporated for implemention in the Federal Register. *Mark-To-Market Valuation Software*, 62 Fed Reg 29,188 (1997). Your office is concerned that the April demonstration, and publicity surrounding the development of the software, will prompt FOIA requests for the software while it is still in the developmental stage. It is our understanding that the IRS intends to make this software fully available to the public once production is complete.

We have discussed the software with Suzanne Boule of your office, and we understand that the software is designed to assist the IRS in the development of certain rules with regard to financial derivatives where none have existed before. [redacted] DP

Electronic Data Under the FOIA

The Freedom of Information Act, 5 U.S.C. § 552, was enacted in 1966 in an effort to provide the public with a mechanism to gain access to federal "agency records." The statute is intended to require federal agencies to provide these records to any requester, subject to nine enumerated exemptions. Although the term "agency records" was not defined in the statute, courts had generally interpreted the term to extend beyond mere "paper" and to include videotapes, audiotapes, microfilm,

microfiche, etc. See, e.g., Long v. IRS, 596 F.2d 362, 364-65 (9th Cir. 1979), cert. denied, 446 U.S. 917 (1980); Yeager v. DEA, 678 F.2d 315, 321 (D.C. Cir. 1982). However, there has always been some question as to whether electronic data was encompassed in the term "agency records." In order to clarify this issue, and address other concerns related to electronic data, this past fall, Congress enacted, and President Clinton signed into law, the "Electronic Freedom of Information Act Amendments of 1996," P.L. No. 194-231, 110 Stat. 2422. Among other things, these amendments define "agency record" to include "any information that would be an agency record subject to the requirements of [FOIA] when maintained by an agency in any format, including an electronic format." 5 U.S.C. § 552(f)(2). Since the "Mark-to-Market Valuation Software" is being developed by the Los Alamos National Laboratory under contract with the IRS so that it is under the control of the IRS, and given that the format of the data falls squarely within the definition in the recent FOIA amendments, the software is certainly an "agency record". See Forsham v. Harris, 445 U.S. 169 (1980).

Therefore, unless data contained in the "Mark-to-Market Valuation Software" falls within one of the nine enumerated exemptions to the FOIA, codified at 5 U.S.C. § 552(b)(1)-(9) and (c)(1)-(3) (not relevant herein), it would be available to the public upon request. Since the data at issue here is still in the developmental phase, the deliberative process privilege, codified at 5 U.S.C. § 552(b)(5), is the exemption most relevant to the matter at hand.

Exemption 5

Exemption 5 exempts from disclosure "inter-agency or intra-agency memorandums or letters which would not be available by law to a party ... in litigation with the agency." The three most common privileges encompassed in exemption 5 are the attorney-client privilege, the attorney work product privilege and the deliberative process privilege. With regard to your inquiry, the deliberative process privilege appears to be the most germane.

In order for data to fit within this category, it must be both "predecisional" and "deliberative." Although there is no touchstone in applying this privilege, opinion is generally protected, in contrast to factual information. See EPA v. Mink, 410 U.S. 73, 87-91 (1973). However, this distinction between fact and opinion may not be conclusive, as "the disclosure of even purely factual material may so expose the deliberative process within an agency" as to warrant the application of the privilege to that material. Mead Data Central, Inc. v. Department of Air Force, 566 F.2d 242, 256 (D.C. Cir. 1977). This privilege furthers three policy bases, in that it (1) promotes broad consideration of alternatives and improves the quality of decisions; (2) prevents premature disclosure of ongoing discussions that might confuse the public; and (3)

protects the integrity of the decision-making process, by making sure officials are judged on what they decide, not what they consider. Jordan v. DOJ, 591 F.2d 753, 772-72 (D.C. Cir. 1978).

As you have described the situation to us, the "Mark-to-Market Valuation Software" is currently under development and your office is concerned about requests for data associated with this software before the product is finalized. We believe that such data is exempt under the FOIA prior to its finalization by virtue of exemption 5 and the deliberative process privilege. As the court in Cleary, Gottlieb, Steen & Hamilton v. HHS, 844 F. Supp. 770, 783 (D.D.C. 1993) noted, computer software is "within the protected sphere of the deliberative process privilege, because [this] privilege encompasses the decision-making process behind the culling and selection of relevant facts." The court explained that "computer programs reflect their creator's mental processes, and therefore fall under Exception 5." Quoting Montrose Chemical Corp. v. Train, 491 F.2d 63 (D.C. Cir. 1974), the Cleary court stated that "[t]he work of assistants in separating the wheat from the chaff is surely just as much a part of the deliberative process as is the later milling by running the grist through the mind of the administrator. The software programs merely memorialize this separation magnetically, translating the culling process envisioned by the creators into a language that the computer can follow." Id. Therefore, we believe that data associated with the unfinished version of the "Mark-to-Market Valuation Software" would not necessarily be available to a requester under FOIA.

The decision to assert those privileges encompassed in exemption 5 is entirely discretionary to the agency. The Commissioner has set forth a "pro-disclosure" posture with respect to the availability of agency records under the FOIA. Former Policy Statement P-1-192, now incorporated in IRM 1230, Internal Management Document System Handbook, at text 293(2), provides that the IRS will grant a request under the FOIA for a record which is not prohibited from disclosure by law or regulations unless the record is exempt from required disclosure under the FOIA and public knowledge of the information contained in such record would significantly impede or nullify IRS actions in carrying out a responsibility or function, or would constitute an unwarranted invasion of personal privacy. Moreover, by memorandum dated October 4, 1993, Attorney General Janet Reno stated that the Department of Justice "will no longer defend an agency's withholding of information merely because there is a "substantial legal basis" for doing so." Rather, Attorney General Reno stated, the Department of Justice shall defend the assertion of a FOIA exemption "only in those cases where the agency reasonably foresees that disclosure would be harmful to an interest protected by that exemption." In applying this `foreseeable harm standard,' each request must be considered on a case-by-case basis, i.e., as Attorney General Reno noted, through "consideration of the reasonably expected consequences of disclosure in each particular case." Therefore, under IRS internal policy and the Reno guidelines, you

must weigh the consequences of the release of data associated with each FOIA request you receive for information related to the unfinished version of the "Mark-to-Market Valuation Software" and determine whether or not there is foreseeable harm to the IRS in the release of this data. Please note that the decision to waive the privilege with regard to one requester would be interpreted as a waiver with regard to all similarly situated requesters.

Exemption 4

Exemption 4 provides that the FOIA does not apply to matters that are "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. § 552(b)(4). At first glance, it would seem that this exemption could apply to software used to value financial derivatives since a trade secret has been defined as "an unpatented secret, commercially valuable plan, appliance, formula, or process, which is used for the making, preparing, compounding, treating, or processing of articles or materials which are trade commodities." Consumers Union v. VA, 301 F. Supp. 796 (S.D.N.Y. 1969). However, the requirement that the product be "obtained from a person" means that if the information was generated by, or on behalf of, the Government, it cannot fall within exemption 4. Id. We have not seen the contract which the IRS entered into with the Los Alamos National Laboratory for development of the "Mark-to-Market Valuation Software," and it may be possible that Los Alamos has retained some sort of proprietary interest in the product. If the IRS is the "owner" of this software, however, it is not subject to exemption 4.

Retention of Discarded Data

You had also expressed concern as to what records associated with the development of the "Mark-to-Market Valuation Software" should be retained (presumably after a determination had been made that such records would not be incorporated into the final product) in order to comply with FOIA requests. The question of record retention does not depend on anticipated FOIA actions. If destruction of this data falls within applicable record retention schedules, there is no need to save that data in anticipation of FOIA requests. However, if a FOIA request is received, the agency cannot destroy requested records even if permitted under applicable record retention schedules. See, 26 CFR § 601.702(c)(12).[1] Also, please be advised that a FOIA requester is entitled only to records that an agency has in fact chosen to create

[1] If you are unsure as to the applicable record retention schedule for this data, please contact Sharon Andrews on (202) 874-1698 for assistance. Ms. Andrews is responsible for records management in the Office of the Assistant Commissioner (International).

and retain; an agency need not obtain or regain possession of a discarded record in order to satisfy a FOIA request. Kissinger v. Reporters Committee for Freedom of the Press, 445 U.S. 136 (1980).

If you have any questions or need additional information, please contact Deborah Lambert-Dean on 622-4570.

DONALD M. SQUIRES